California Organized Investment Network

C O I N

Application Procedures and Guidelines

California Department of Insurance
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MISSION STATEMENT

COIN's mission is to provide leadership in increasing the level of insurance industry capital in safe and sound investments providing fair returns to investors and social benefit to underserved communities.

FORMATION OF COIN

In 1995, legislation was introduced by Assemblywoman Barbara Lee (AB 1557) and Senator Richard Polanco (SB 1217) to increase insurance industry investment in low-income areas. These bills would have done the following:

AB 1557:

This bill would have required life insurance companies to place 1 percent of the premiums collected in California in investments in California's low-income communities. Property/casualty companies would have been required to invest ½ of one percent of premiums collected. The bill included requirements regarding community investments and enforcement for the Commissioner of the Department of Insurance.

SB 1217:

The bill stated that insurers had an obligation to make investments in low-income communities and also required a disclosure statement. This bill contained no penalties or enforcement for noncompliance, and required no minimum amount of investment. The measure required the Insurance Commissioner to report back to the Legislature on insurers' progress in making community development investments.

While their authors were pursuing these bills, a task force was formed. This working task force consisted of Department of Insurance staff, staff from the authors of the two bills mentioned above, representatives of several industry trade associations and insurance companies, and representatives of community economic development groups, housing groups, and consumer groups.

The task force generated a proposal to create the California Organized Investment Network (COIN) within the Department of Insurance, which would act as a clearinghouse of investment needs. A specific proposal for COIN was described in a letter from Insurance Commissioner Quackenbush to Assemblywoman Lee and Senator Polanco dated August 29, 1995. An allocation for COIN's start-up funding was included in Governor Wilson's May revision of the 1995-96 state budget.

With a budget and universal support, the Department of Insurance began a comprehensive search for COIN's Director, and worked with the insurers, legislators, and consumer groups to create an Advisory Board to advise and assist COIN in its unique mission. The first Director, Jan Owen, took office in February 1996 and COIN was officially started. Michael A. Gunning took over as Director in December 1996 and in February 2000, Delores A. McKinnon became the third Director.

ADVISORY BOARD

The COIN Advisory Board consists of voluntary representatives of insurance investment and legal executives, California Legislators, the Insurance Commissioner, consumer advocates and practioners in the fields of affordable housing and local economic development throughout the State of California.

The Advisory Board is an integral part in the success of COIN. It provides operation assistance to the Director and staff. Equally important, the Board must provide a forum for the exchange of information between the industry and investment representatives and assists COIN in disseminating information and solving obstacles that might hinder the goals of the program.

CONCLUSION

COIN is a vital part of an overall effort to increase the insurance industry's presence in all California communities and foster the State's economic development. For too long, urban communities have not shared fully in the opportunities that other areas have enjoyed. COIN is an exciting and innovative development that builds relationships where none previously existed. It will pay huge dividends down the road.

APPLICATION PROCEDURES and GUIDELINES

The California Organized Investment Network (COIN) maintains an open window application process, with applications to be continuously received through the office of the Program.

COIN will review applications to determine compliance with the investment policy. All applicants must satisfy the investment policy to be deemed eligible for COIN facilitated investments. In the event an applicant does not meet the investment policy, COIN will communicate the reasons, offer technical assistance, and if desired by the applicant, assist to revise the proposal in a manner consistent with the investment policy, to the extent possible.

COIN will notify the applicant of the results of the investment policy review upon completion of the eligibility review of the application.

If applicants express a desire to receive a National Association of Insurance Commissioner's Securities Valuation Office (SVO) rating for their applicant, COIN will attempt to provide such assistance (see Appendix for further details on the SVO).

Proposals which are deemed eligible for a COIN facilitated investment will be made available through the Department's bulletin process and Web site to all insurance companies doing business in California. COIN will be responsible for tracking COIN-facilitated investments.

A statement of program effectiveness and associated reporting will be required from each successful applicant. This statement is to include a discussion on how the program achieved or failed to achieve its stated compliance with COIN's guidelines.

COIN will provide the Advisory Board with a quarterly report summarizing the applications received, their status and disposition.

Applications from practioners should comply with the following guidelines:

1. Name of proposing organization and contact information

2. Legal status of the organization (e.g., corporation, sole proprietorship) and taxpayer ID number

3. Description of proposing entity to include:

    a. Experience
    b. Financial capability

4. Description of proposed project or program:

    a. Specify dollar amount requested for the product or program
    b. Describe type of financing requested to include proposed terms as appropriate
    c. Specify compliance with COIN's three guiding principles of the investment policy

5. When appropriate for the proposal please supply the following:

    a. Debt coverage ratio
    b. Loan-to-value ratio
    c. Appraisal
    d. Audited financial statements, 3 years of most recent
    e. Sources and uses statements, 3 years of most recent
    f. Operating budgets
    g. Collateral positions
    h. Credit enhancement

    If a venture fund, please also include the following:

    a. Years of experience
    b. Industry focus
    c. Geographical concentration
    d. Funds under management
    e. Experience working with small and growing companies
    f. Three references
    g. Copy of organization's 501/c/3 letter

6. COIN's mission of supplying capital to low-income and rural communities is intended to be innovative. The application process and the application itself should encourage innovation in an effort to respond to the unmet credit needs of low-income and rural communities consistent with COIN's investment policy.

As a pre-requisite for review of any investment proposal, applicants must comply with the above guidelines. Please contact COIN at (916) 492-3525 with any questions. Mail applications to:

California Department of Insurance
California Organized Investment Network
300 Capitol Mall, Suite 1600
Sacramento, CA 95814

INVESTMENT POLICY

This document sets forth the investment policy of COIN. Programs and projects must satisfy the guidelines of the investment policy to receive assistance from COIN.

This investment policy was recommended by the COIN Advisory Board to the Insurance Commissioner. The COIN Advisory Board is comprised of voluntary representatives of insurance investment and legal executives, California Legislators, the Insurance Commissioner, consumer advocate groups, and practitioners in the fields of affordable housing and local economic development throughout the state of California.

COIN was established in 1995 as a collaborative effort between the insurance industry, the Commissioner of Insurance, and advocates for investment in low-income communities. COIN's mission is to match entrepreneurs, non-profit groups, and local governments either directly or through intermediaries with insurance industry investment capital. The ultimate goal of this effort will be to increase the level of insurance industry investment in safe and sound investments for economic development and affordable housing in or benefiting low-income and rural communities.

COIN may exercise discretion in determining benefit to low-income and rural communities other than in areas of affordable housing and economic development. It is the intent of COIN's investment policy to encourage innovation in responding to unmet capital needs of low-income and rural communities, their residents, businesses, and non-profit community service organizations. While the priority of COIN is affordable housing and economic development, COIN will have the discretion to look at all types of investments.

I. Types and Amounts of Investments

COIN intends to facilitate the offering of a comprehensive array of investment products responsive to capital needs of low-income and rural communities. Accordingly, the COIN investment policy envisions no limit on the type or nature of capital investment which insurance companies may provide to eligible proposers. However, broadly categorized, COIN-facilitated investment products may be versions of debt, equity, or credit enhancement.

COIN will not solicit proposals for grants or charitable giving. COIN encourages proposers throughout California to be bold, ambitious and innovative in developing proposals for insurance industry funding which complies with COIN's investment policy. COIN's investment policy does not envision a limit on the dollar amount of COIN investment proposals and commitments.

II. Three Guiding Investment Principles

To be eligible for a COIN investment, proposers must satisfy each of the three guiding investment principles:

A. Provide safe, sound, and solvent investments offering an acceptable financial return or its equivalent within the regulatory and NAIC rating framework governing insurance company investments.

B. Provide investments in or benefiting low-income and rural people or communities either directly or through intermediaries.

C. Add value to capital products and programs currently available.

A. <u>Provide Safe, Sound, Solvent Investments Offering an Acceptable Financial Return</u>

Proposals for COIN facilitated investment by insurance companies must offer insurance companies safe, sound, solvent investments with an acceptable rate of return. COIN facilitated investments will remain in keeping with existing laws and regulations governing investments made by insurance companies. The COIN investment policy expressly recognizes that insurance companies have an obligation to their policyholders to manage assets with liabilities, and to their shareholders to provide an acceptable financial return.

The guiding investment principles of a COIN investment will be:

1. If the project or proposal appears to be of investment grade quality, COIN will notify, by bulletin and/or Department Web site, all California admitted insurance companies that the investment opportunity exists.

2. If the project or proposal is not of investment grade quality or does not fit within the Department of Insurance Investment Guidelines for Insurance Companies:

   a. The COIN staff may notify, by bulletin or Department of Insurance Web site, all California admitted insurance companies that an investment opportunity exists which appears not to be of an NAIC investment grade or does not meet the Department of Insurance Investment Guidelines for insurance companies; however, insurance companies may want to consider the investment within their investment programs; or

   b. COIN may assist the entity submitting the project or proposal in obtaining a National Association of Insurance Commissioners (NAIC) rating or assist in any other way to structure or package the project or proposal so that it would qualify with the guidelines; or

   c. The person submitting the project may withdraw it from consideration.

3. As used in these procedures, a project or proposal of investment grade quality means a project rated by the NAIC Securities Valuation Office (SVO) which carries an NAIC SVO Designation 1, 2, P1, P2, PSF1, PSF2, or carries an equivalent rating from other nationally recognized rating services such as Moody's or Standard & Poors.

4. Department of Insurance guidelines are available through COIN.

B. COIN Facilitated Investments Shall Demonstrate Benefit to Low-Income Rural Communities

Proposers seeking COIN facilitated investments must demonstrate benefit to low-income and rural communities. Community benefit for investment products classified as affordable housing and economic development as defined below.

1. Affordable Housing Community Benefit.

Affordable housing COIN investment proposals must demonstrate community benefit by complying with at least one of the following standards. Affordable housing priorities will be given to the lowest income benefit programs.

a. Affordable Rental Housing.

Programs or projects producing, providing or preserving rental housing at a housing expense affordable to households at or below 60 percent of the area median income. Projects receiving COIN investment assistance for affordable rental housing may be located anywhere in the State. Affordability controls must be secured by regulatory agreement, ground lease, a loan agreement, or other enforceable regulatory control for a minimum term of 30 years.

b. Affordable Ownership Housing.

Programs or projects seeking COIN investment capital for affordable home ownership must provide ownership opportunities:

1. At a housing expense affordable to households at or below 100 percent of the area median income, adjusted for family size, for housing units located anywhere in California; or

2. At a housing expense affordable to households at or below 120 percent of the area median income, adjusted for household size, for units located in census tracts with a tract median income of less than 80 percent of the area median income. However, COIN places a high priority on serving lower-income households. COIN's effectiveness will be judged accordingly.

For ownership units located in rural communities, ownership units may be offered at an affordable housing expense to households at or below 100 percent of the area median income.

Ownership units must carry enforceable resale controls to the same targeted income levels for a minimum term of five years if there are public funds or land use restrictions which require income restrictions for the unit.

c. Mixed Income and Mixed Use Development.

Programs and projects for mixed income housing and/or mixed use development including a residential component will be eligible COIN-facilitated investments if projects provide substantial neighborhood revitalization benefits and are located in low-income census tract areas (defined as tracts with 80 percent or less of the area median income) or rural communities as defined in this investment policy. Substantial neighborhood revitalization benefit may be demonstrated by the provision of needed social services, retail and office space benefiting area residents and businesses, as well as other benefits documented by the applicant.

Attached to this policy is a number of suggested delivery mechanisms that may be used for COIN-facilitated affordable housing investments. This list is intended to be illustrative, rather than exclusive. In some cases the types of investments may also be accepted through an intermediary working with insurance industry capital.

2. Economic Development Community Benefit.

COIN facilitated investment proposals may satisfy the community benefit criterion by demonstrating economic development benefits to low-income and rural communities, residents, businesses, and non-profit community service organizations. To comply with the economic development community benefit task, proposers must meet a geographic targeting requirement.

1. Geographic Targeting of Economic Development Investments.

COIN facilitated proposals may satisfy the geographic targeting task for economic development in one of two ways.

a. Commercial real estate investments for developments located in low-income census tracts or rural communities. Low-income census tracts are those of a median tract income of 80 percent or less of the area median income.

b. Business investments other than commercial real estate development located in low-income census tracts or rural communities qualify for enterprises with business addresses in either a low-income census tract, or a rural community. Business address may include headquarters operations, branch, plant, office, franchise, or other operations, as long as the proposal demonstrates a link between the business address and is located within a low-income census tract and/or rural community.

COIN facilitated economic development investments in geographically targeted areas will be reviewed without regard to the size of firm, development or enterprise, and without a limit on the size of the investment requested.

A. Delivery Mechanisms.

COIN economic development investment initiatives may be delivered through several mechanisms. These include:

a. Community development lenders and investors,
b. Conventional lenders and investors,
c. Local or state government agencies active in economic development financing, and
d. Enterprise specific and development specific proposers.

The COIN Advisory Board places special emphasis on building the capital, staff, management, and infrastructure capacity of the community development lender and investor sector. Community development lenders and investors are defined to include community development financial institutions, community loan funds, financial intermediaries, minority-owned financial institutions, regulated financial institutions with assets of less than $1 billion, community credit unions, loan or investment funds operated by non-profit organizations or government agencies, Business Industrial Development Corporations (BIDCO), and community development equity funds. The COIN economic development investment policy seeks to assist this important financial sector to grow substantially so that it may more effectively serve economic development capital needs in low-income and rural communities.

Individual enterprises, public agencies, and developers are encouraged to submit capital requests consistent with COIN's economic development investment policy.

Attached to this investment policy are examples of economic development investment programs which meet COIN's investment policy. This list is intended as illustrative, not restrictive. Applicants are encouraged to be bold and innovative in their requests to COIN, while at the same time complying with COIN's investment policy.

C. COIN Facilitated Investments Should Add Value to Capital Products and Programs Currently Available in the Marketplace

It is the intent of the investment policy of COIN that insurance industry investment programs and products add value to those currently available in the marketplace.

Accordingly, COIN investment proposals should demonstrate added value to the supply of capital to low-income and rural markets and products. COIN defines low-income and rural communities as:

1. Geographically

    a. low-income

    1. census tracts (defined as tracts with a median income less than 80 percent of the area median income),

    b. rural communities as defined in the Health and Safety Code §50199.21 below:

    1. the area is eligible for financing from the United States Farmers Home Administration under its Section 515 Program, or Successor Program,

    2. the area is not located in a metropolitan area,

    3. the area is an incorporated city having a population of 40,000 or less, or is located in the unincorporated area which adjoins that city, provided that the city and its adjoining unincorporated area is not designated as an urbanized area by the United States Census Bureau or are not part of such an urbanized area.

    4. other areas may be deemed to qualify as a rural community at the Commissioner's discretion.

COIN facilitated investments must demonstrate added value through either:

1. Providing capital to low-income and rural markets, which may be defined geographically and/or by investment product type, or

2. Improving upon existing capital products by some combination of enhanced pricing, terms, conditions, and credit standards.

EXAMPLES OF HOUSING INVESTMENT PROGRAMS

1. Permanent Fixed-Rate Debt for Low Income Rental Housing

The need typically is for fixed-rate term loans fully amortizing over 30 years at comparable or premium rates. Fixed rates generally available today are at Treasuries plus 200 basis points or C.I.P. plus 150 to 175 basis points.

Example: A typical project requiring funding will be anywhere from 20 to 150 units of either family or senior housing. Loan to value for the term loan is 75 percent to 80 percent, with a debt coverage ratio of 1.15 to 1.25. Rents will be approximately 20 percent below market. Public sector dollars will be subordinated, although deed restrictions may not.

2. Permanent Fixed Rate Debt for Mixed Use Housing in Inner-City Areas

The need is for fixed-rate term loans fully amortizing over 30 years for projects which combine affordable housing and commercial space. (See Permanent Fixed-Rate Debt, above for funding parameters on the housing portion of the project.) Most lenders either will not consider the commercial income as part of the pro forma, or will limit it to a percentage, e.g., 35 percent. This can have a major impact on the funding feasibility should the commercial space be substantial relative to the residential space. There is a need for more flexible underwriting standards.

3. Predevelopment Loans

Predevelopment funds are no longer available through the State of California. In the past, this has been an extremely desirable program to cover such predevelopment costs as preliminary drawings, land options, market studies, engineering surveys, etc. There are a few intermediaries who will provide similar funds, but their capital amounts are limited; some are constrained geographically (e.g., rural areas only.) Examples include Low Income Housing Fund, Northern California Community Loan Fund, Rural Community Assistance Corporation, Housing Assistance Council, and Mercy Loan Fund. A few conventional lenders also provide predevelopment funding.

Example**:** A typical borrower requires predevelopment funds ranging in size from $50,000 to $500,000 for projects which would come to fruition (start of construction) approximately 9 to 12 months down the road. Interest rates are usually 6 percent to Prime plus 100 basis points (depending on the source of funds.) These loans may be unsecured and usually have 18-month maturities.

4. Permanent Fixed-Rate Debt Through Funding Existing Intermediary Lenders

There are several existing intermediary lenders whose members pool their funds to limit their risk. These intermediaries are in need of additional capital to lend. They utilize existing and experienced staff to underwrite and monitor deals. Examples include the California

Community Reinvestment Corporation and SAMCO, consortia of banks and savings and loans, respectively. Terms would be as in Permanent Fixed Rate Debt, above.

5. Long-Term Loans Based On Short-Term Variable Rates, With Interest Rate Caps and Collars

Long-term loans (10 years or more) can be increased in size if the loan's interest rate can be reduced. Variable rate loans generally have lower interest rates than do fixed-rate loans and represent a possible method of effecting such loan interest rate reductions. However, unless some restriction on the degree of upward rate variation is offered to the borrower, it is not possible to take full advantage of variable rate loans. An interest rate "cap" may be used as a form of insurance contract wherein the insured pays a one-time fee to the insurance company who in turn agrees to remit to the insured periodic payments if interest rates exceed a defined level. The amount of the payments is proportional to the length of time and the degree to which rates exceed the defined level. Relatively long-term rate caps are required for this tool to be of significant value to affordable housing developer/owners.

Example: A proposed 30-year, fixed-rate loan at 7.5 percent is debt service constrained at $1 million. Today's variable rate of interest for this loan is 4.5 percent. If the loan is changed to a variable rate loan and the borrower has a 15-year, 6.0 percent rate cap, then the loan could increase to $1.165 million, assuming no loan-to-value constraint restricted the increase. A corresponding decrease in otherwise required public funding also occurs. A portion of the funding benefit is applied to the purchase price of the rate cap.

6. Warehousing To Facilitate Pooling/Seasoning of Affordable Housing Term Debt Loan

The secondary market for unseasoned term loans on multifamily affordable housing projects is poorly developed and the lack of a secondary market for such loans inhibits the participation of many lenders otherwise interested in supplying long-term affordable housing debt. The three principal explanations for the lack of such a secondary market are (i) the lack of a performance track record for individual loans; (ii) the relatively small size of individual loans; and, (iii) the lack of underwriting and documentation standardization of such loans. An insurance company (or consortium of companies) who was willing to buy smaller, newly originated affordable housing loans pursuant to a standard set of documents and underwriting criteria could facilitate the deepening of such a secondary market. The underwriting and documentation standards would need to be designed with a view to the future pooled resale of the loans once they had achieved several years of seasoning. Future pooled resale would permit insurance industry capital committed to such an initiative to be recycled over time. As most such loans would likely be long-term, fixed-rate loans, the pooling and warehousing process would likely benefit from some mechanism to reduce or eliminate the risk of adverse resale loan value changes attributable to changes in the interest rate environment.

Example: Ten $3 million term real estate loans are originated by ten smaller banks or thrifts. In each case, the real property asset financed is a multi-family project with below-market rents. All of the borrowers are private, not-for-profit organizations with good operating histories but with limited capital resources. The originating lenders, because of balance sheet size and capital constraints, have limited appetite for such loan product and are unlikely to originate additional loans unless they can sell these loans. An insurance company buys the loans and holds them for 3 years after which they are pooled and sold. If sold to FNMA, a gain on resale may result. Servicing is retained by the originating lender.

7. Targeted Equity Investments Paying Premium Pricing for Low Income Housing Tax Credits for Difficult Projects/Difficult Areas

Investments in affordable housing utilizing the Low Income Housing Tax Credit have become well-established, with major corporations investing either directly or through pools. There is a need for premium pricing for projects in inner-city areas or projects serving difficult populations, such as the homeless or those with special needs. These projects serve those in greatest need, yet other funding is often limited.

8. Bridge Loans for Low Income Housing Tax Credits

Some investors in Tax Credit projects pay into their investment over several years (3-8.) However, the construction lender in the project needs to be paid off at the end of construction. Typically, a bridge loan pays off the construction lender and is repaid from the investor payments as they come in over the specified time period. The bridge loan is secured by the investor commitments to payments, some of which contain conditions. There are intermediary organizations such as LIMAC that use pooled funds to make bridge loans.

9. Direct Placement of Tax Exempt Bonds

Tax exempt bonds provide lower interest rate mortgages to affordable housing projects. However, the transaction costs incurred are often very high due to the need to go out to the market to sell the bonds. Many of these costs can be reduced substantially if the bonds are placed directly with a single purchaser (e.g. insurance companies.)

10. Subordinated Debt That is Repaid from Cash Flow

In some transactions, particularly some types of bond financing, the loan-to-value ratio is very low (70-75 percent), so that significant cash flow is generated. This cash flow could be used to repay subordinate debt. Insurance companies could make such loans or provide credit enhancement for other lenders who would make such loans.

11. Permanent Debt Structures For Small Multi-Family Developments

A typical deal would be a 30-year fully amortizing fixed rate loan to a nonprofit organization that provides affordable housing. The project would have to 36 rental units, and be subject to rent restrictions. There may be junior debt provided by the City or County which would contain the rent restrictions. Loan requests would range from approximately $250,000 to $3,000,000 that would include competitive underwriting conditions.

12. Multi-Family REO Acquisition And Predevelopment Financing

Fixed-rate permanent 30-year fully amortized financing at competitive pricing, terms and conditions are needed to acquire foreclosed or troubled multifamily projects or assets from financial institutions, FHA, or FDIC. Predevelopment financing for nonspeculative buyers willing to preserve discounts realized through long-term rent restrictions.

13. Premium Pricing For Targeted Mortgage-Backed Securities

Programs which provide targeted mortgage backed securities for home ownership or rental housing in inner-city neighborhoods at 100 basis point price premium.

14. Taxable Private Placement Debt Structures to Finance Pledges of Redevelopment Agencies' Property Tax Increment Cash Flow

A Redevelopment Agency can pledge a fixed annual amount for 30 years to a non-profit housing development corporation to provide gap financing for a very low-income rental housing development. The lender (i.e., insurance company) provides a mortgage loan secured by the housing development real estate and the redevelopment agency pledge of cash flow.

Alternatively, a Redevelopment Agency can pledge a variable amount of annual tax increment, based on availability, for 30 years to a non-profit housing development corporation for the production of both very low income rental and low income ownership housing in inner city communities. The lender (i.e., insurance company) provides a non-recourse loan to the non-profit corporation whose principal security and source of repayment is the pledge of tax increment cash flow. The non-profit must use the loan proceeds to develop affordable housing as stipulated.

15. Mortgage Insurance Risk Sharing Structures with Public Partners Such As FHA and the California Housing Finance Agency -- Multifamily and Single Family

Single family: Insurance company places funds in a reserve account, with a stipulated return, with the California Housing Loan Insurance Fund providing property mortgage insurance to 97 percent loan-to-value mortgages to low and moderate income first time home buyers in target areas. Reserve funds are required on account for limited term, e.g., five years.

Multifamily: Insurance company provides mortgage insurance for multi-family debt in structured, multiclass securities with varying risk exposures taken by the insurer and other lenders (e.g., banks, thrifts, consortia, community development lenders, public agencies, intermediaries.)

16. Loan Pool for Long Term Debt to Initiate Lease-Purchase Developments

Insurance company provides 30-year fixed rate fully amortizing financing for town home units developed in downtown area with lease-purchase arrangement for first time income eligible buyers. The mortgage converts from a multifamily mortgage to individual condominium mortgages when the lease-purchaser buys his or her unit.

EXAMPLES OF ECONOMIC DEVELOPMENT INVESTMENT PROGRAMS

1. Venture fund equity investments for targeted firms. Examples may include placing equity investments with intermediaries such as the Fannie Mae Venture Fund, the Minority Equity Financial Assistance Corporation, minority-owned venture capital firms, Business Industrial Development Corporations (BIDCO), or other sources of equity investment for minority-owned and women-owned firms, or for firms located in low-income and rural communities.

2. Predevelopment, construction, permanent loans and equity for "flagship" real estate development in low-income and rural communities, e.g., partnerships to purchase and/or develop retail shopping centers in minority communities, long term, fixed rate fully amortizing permanent loans for commercial development in low income communities.

3. Small business loan portfolio purchases providing added value through improved pricing, terms, conditions and credit standards.

4. Provisions for loan capital, risk sharing credit enhancement, and/or equity capital for "technical assistance-enriched business lending" in targeted communities and for targeted enterprises. "Technical assistance-enriched business lending" is defined as lending which provides marginally larger loan amounts with a requirement to finance the provision of needed technical assistance to stabilize and grow the borrower's business.

5. Risk sharing and economic development loan and equity portfolios.

6. Purchase of shares, placing deposits under contract, providing pass-through payments with community development financial institutions, community credit unions, or other private community lenders.

7. Private placement and taxable financing of California Redevelopment Agency pledge of property tax increment financing for projects and programs which qualify under COIN's economic development investment policy.

8. Letters of credit, credit enhancement, surety bond programs for minority contractors.

9. Business Industrial Development Corporation (BIDCO) equity investment.

10. Entrepreneurship graduate loan program operated through community lenders conventional lenders, public agencies, or non-profit organizations.

REPORTING REQUIREMENTS OF COIN INVESTMENT RECIPIENTS

Applicants receiving investment capital through COIN must provide COIN with an annual report on the results of their program or project. Minimum reporting requirements must include, to the extent applicable to the proposer's program or project, the following:

I. Affordable Housing

1. Rental Housing

The number of rental units affordable to households below 35 percent of the area median income, adjusted for household size, as defined under California Law; number of rental units affordable to households between 35 and 50 percent of the area median income, adjusted for household size, as defined under California law; number of rental units affordable to households between 50 and 60 percent of the area median income, adjusted for household size, as defined under California law; number of rental units affordable to households between 60 and 80 percent of the area median income, adjusted for household size, as defined under California law; and the number of rental units affordable to households greater than 80 percent of the area median income, adjusted for household size, as defined under California law.

2. Ownership Housing

a. Number of units located in census tracts with median income at or below 80 percent of the area median income, and affordable to:

households less than 50 percent of the area median income, adjusted for household size, as defined by California State law; households between 50 and 80 percent of the area median income, adjusted for household size, as defined by California State law; households between 80 and 100 percent of the area median income, adjusted for household size, as defined by California State law; households between 100 and 120 percent of the area median income, adjusted for household size, as defined by California State law; and households greater than 120 percent of the area median income, adjusted for household size, as defined by California State law.

b. For ownership units located in rural communities as defined:

at or below 50 percent the area median income, adjusted for household size; between 50 and 80 percent of the area median income, adjusted for household size; between 80 and 100 percent of the area median income, adjusted for household size; greater than 100 percent of the area median income, adjusted for household size.

Reporting Requirements (continued)

For ownership units affordable to households at or below 80 percent of the area median income, report the location and number of units by census tract according to the following income and ethnic characteristics of the tract:

Tract Income Level	Tract percent Minority Population
less than 50 percent area median income	0 to 10 percent minority population
between 50 and 80 percent area median income	10 to 20 percent minority population
between 80 and 100 percent area median income	20 to 30 percent minority population
between 100 and 120 percent area median income	greater than 30 percent minority population
greater than 120 percent median area income	

3. Mixed Income and Mixed Use Developments

Applicants requesting COIN facilitated investment capital for mixed income and/or mixed use developments must annually report, in addition to the housing reporting requirements to COIN the following information for specific developments receiving COIN investment capital:

- Dollar amount of insurance capital invested; type of investment products (describe), e.g., debt, equity, credit enhancement, other

- Description of community service, office, retail space (square footage) and facilities (use)

Applicants may otherwise describe neighborhood revitalization benefits in their annual reporting to COIN.

II. Economic Development

1. For commercial real estate development financing, the following information should be reported:

Location of the commercial development by the median income of the census tract:

a. less than 50 percent of the area median income;

b. between 50 percent and 80 percent of the area median income;

c. a census tract located in a rural community.

2. For economic development investments other than commercial real estate and located in low-income census tracts or rural communities, the following information should be reported:

a. address and census tract median income of the headquarters of business receiving COIN investment capital;

b. address and the census tract median income of the business operation located in a low-income or rural census tract;

c. race of the business owner (ownership defined as greater than 50 percent ownership share);

d. gender of the business owner (ownership defined as greater than 50 percent ownership interest);

e. number of jobs created, average length of employment for newly created jobs directly resulting from COIN investment. Among all employees, list:

- employee ethnicity (African-American, Hispanic, Asian-American, Native American, other);
- gender;
- residential address of all employees by census tracts with median income:

1. less than 50 percent of the area median income;
2. between 50 and 80 percent of the area median income;
3. greater than 80 percent of the area median income.

3. Minority and Women-owned Firms, Non-profit Community Service Enterprises

For COIN facilitated investments benefiting minority and women-owned firms and non-profit community service enterprises, recipients of COIN facilitated investment capital should report the following information:

a. Dollar amount of insurance investment capital received;

b. Type of investment product (describe), e.g., debt, credit enhancement, equity, other;

c. Ethnicity of business owner (African-American, Hispanic, Asian-American, Native American, other);

Reporting Requirements (continued)

d. Gender of business owner;

e. Annual income of individuals who own the business;

f. Non-profit community service enterprise annual budget:

- less than $1 million;
- $ 1 million to $5 million
- $ 5 million to $10 million;
- $10 million to $20 million;
- $20 million to $35 million.

g. Number of jobs created, average length of employment for newly created jobs directly resulting from a COIN facilitated investment. Among newly hired employees, list:

- employee ethnicity (African-American, Hispanic, Asian-American, Native American, other);
- gender;
- residential address of all employees by census tracts with median income:

1. less than 50 percent of the area median income;
2. between 50 and 80 percent of the area median income;
3. greater than 80 percent of the area median income.

h. The type of investment capital received (e.g., equity, debt, credit enhancement, other.)

APPENDIX

THE VALUATION OF INSURER ASSETS AND THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS SECURITIES VALUATION OFFICE

Introduction

As the chief public officials charged with the responsibility for monitoring the financial condition of insurers, state insurance regulators must keep a close watch on the quality of insurance company assets. Monitoring the quality and value of those assets is a key component of the regulator's consumer protection function. This outline is intended to briefly describe the Securities Valuation Office and how it establishes National Association of Insurance Commissioners Designations and values for securities held by insurers.

In 1907, the Committee on Valuation of Securities was organized in response to alleged abuses by New York insurance companies in reporting the value of their investments. The National Association of Insurance Commissioners (NAIC) recognized the need for the standardization of securities valuation across the nation and by 1908 published the first volume of Valuations of Securities (VOS) manual. Between 1908 and 1942, the publication was produced for the committee by private statistical agencies. The NAIC established the Securities Valuation Office (SVO) in 1949 to perform analytical valuations on the large and growing number of private securities available.

Today, the SVO is a highly specialized information resource for insurance regulators, insurers, investment bankers, commercial bankers and researchers. The SVO staff, located in New York, helps regulators monitor the financial condition of insurers by examining the quality and value of insurers' investment portfolios. Each January, the SVO publishes the VOS manual, which contains market prices and NAIC Designations for all bonds and stocks owned by U.S.-domiciled insurers when such securities have been filed with the SVO for this purpose.

The SVO's Mission

The mission of the SVO is to provide the members of the NAIC with a source for uniform prices and quality ratings for insurers securities' holdings.

Securities Valuation

The Securities Valuation Office provides insurance regulators with price and quality ratings known as "Association Values" for the securities held by insurers. State insurance regulators require insurance companies to use "Association Values" when they prepare their annual statements. An Association Value is made up of two parts: an actual or estimated market price and an NAIC Designation.

The market price of a publicly traded security is determined by the closing daily price from a stock exchange, or by the bid side of any current quotation for that security[1]. When the price for a security is not available because the security is a private placement, and, therefore, not traded on the open market, the SVO staff analytically determines that value.

The NAIC Designation is a numerical designation that indicates the quality associated with an investment. The NAIC designation measures the characteristics and features of an investment, including its cash-flow, to provide the NAIC members with an indication of whether an investment should be permitted to be amortized or not. The current six-category system of valuation went into effect with the 1990 Annual Statement. The following chart illustrates the new system, along with similar Moody's and Standard & Poor's ratings:

NAIC	Moody's	S&P
1	Aaa, Aa, A	AAA, AA, A
2	Baa	BBB
3	Ba	BB
4	B	B
5	Caa, Ca, C	CCC, CC, C
6	D	D

The comparison to similar ratings assigned by other rating agencies is not intended to indicate that the NAIC Designation is equal to the ratings of those agencies, but rather to provide an analogy of how the SVO will likely treat rated investments.

How the SVO Determines the NAIC Designation for Bonds

Although the SVO assigns NAIC designations to some 42,000 corporate bonds, it performs its credit analysis on individual issuers. There are approximately 11,500 corporate issuers in the SVO's database.

First, the SVO uses ratings performed by other recognized rating agencies[2]. Some 4,000 corporate issuers are so rated.

Second, it is often the case that the valuation of one issue will be supported by the rating of another credit through guarantee, lease, or other form of contractual or collateral support. These third-party supported transactions are frequently structured with any number of different legal instruments, all of which require review to provide the appropriate credit substitution analysis. This analysis seeks to determine the appropriateness of the insurance company's reliance on a third party's credit strength and its representations that the credit

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[1]A securities quotation is comprised of two numbers, a "bid" – representing the amount being offered by potential purchasers of the security – and an "ask" – the price being sought by sellers of the security.

[2]The rating agencies currently recognized by the NAIC for all categories of ratings are Moody's, Standard & Poor's, Duff & Phelps, & Fitch Investors Service, IBCA & Thompson's Bank Watch are recognized.

strength of the third party flows directly to the insurance company. It is important that the third party's promise is in writing, irrevocable and unconditional. Some 40 percent of the corporate issuers in the SVO file are estimated to fall into this category.

Third, a significant number of securities are backed by the full faith and credit of the U.S. government and are, therefore, automatically given the NAIC's highest rating without the need for independent analysis. Examples are securities issued by the Government National Mortgage Association and the Federal National Mortgage Association ("Ginnie Mae" and "Fannie Mae").

Those securities which are independently valued by the SVO are put through a three-stage analysis:

1. The quantitative financial model developed by Zeta Services, Inc., a private analytical service, is applied to current and past financial statement data to determine a preliminary measure of the relative financial soundness of the issuer. While this model is appropriate for testing traditional types of firms, it is not used for companies in regulated industries, most financial services industries (e.g., banks, savings and loans, finance and leasing companies), cable television, certain media industries, and other issuers for which the model is not appropriate. For such issuers, the SVO staff conducts the analysis without reference to the Zeta model. The use of the Zeta model by the SVO is advisory only.

2. In the second phase of the analysis the SVO reviews five years of historical financial data of the issuers where available, as well as any projections available to the SVO. This review includes an examination of the balance sheet, the income statement, and the statement of cash flows. Additionally, the SVO reviews a variety of standard financial ratios, the auditors' opinion, and news reports and search papers regarding the issuer, where such reports and papers are available.

   These first two phases allow the SVO analyst to make a judgment with regard to the issuer's implied senior unsecured debt-paying ability[3]. The ratings of all other securities of the same issuer (including preferred stocks) can be scaled either upwards or downwards, based upon each security's relationship to senior unsecured debt in the capital structure, as well as the strength of the credit.

3. The final phase of the analysis focuses upon the specific security under review. This analysis includes an examination of such indicators of the security's strength as:

   a. covenants,
   b. structure,
   c. collateral,
   d. third-party financial support or other credit enhancements, and
   e. any other fact specific to the security under review.

[3]"Senior unsecured debt-paying ability" refers to the credit-worthiness of a company with respect to the oldest of its obligations that are not secured by collateral.

How the SVO Determines NAIC Designations for Preferred Stocks

The SVO's analysis of preferred stocks rates such stocks equal to the implied rating of the lowest level of debt of the issuing company. The SVO's system of valuing stocks essentially requires the analyst to perform a debt-type analysis and scale the preferred rating from the implied rating of the issuer's subordinated, or lowest, level of debt. Whether a preferred stock
will be rated high quality (1 or 2) or not will depend upon how much debt precedes it in the capital structure and how well both interest and preferred dividends are covered by earnings. All preferred dividends and sinking fund requirements must have been paid for the last three years for any preferred stock to be rated PP-5 or PSF-5 or higher.

The Regulatory Significance of SVO's Bond and Preferred Stock Designations

The regulatory significance of the SVO's bond and preferred stock designations lies in their use in establishing values for insurer-held securities and the size of their reserves, a component of insurers' liabilities, as reflected on the insurers' Annual Statements filed by insurance companies with state regulators. Establishing values for these assets and reserves is of considerable significance for insurers, whose ability to write insurance (otherwise known as "capacity") is based upon the adequacy of their surplus (net worth), which is in turn based upon how much must be removed from surplus to fund the credit quality reserve.

Through the use of SVO's bond and stock valuations, state insurance regulators may impose a form of risk-based capital requirement upon insurers. Applying these requirements to property/casualty insurance companies will be addressed here, while their application to other insurers will be addressed in the following section, dealing with the Asset Valuation Reserve.

Property/Casualty Insurers

Property/casualty insurers are required to value bonds not receiving a designation or 1 or 2 at the lesser of amortized cost or market value (popularly known as "marked-to-market"). Conversely, bonds receiving a 1 or 2 designation are valued at amortized cost.

A similar distinction is made with regard to preferred stocks, with a slight variation. Preferred stocks receiving a designation of PP-1 through PP-6 or PSF-3 through PSF-6 must be valued at the lower of cost, amortized cost, or market value. Those receiving a designation of PSF-1 or PSF-2 will be valued at the lower of cost or amortized cost. [4]

[4] A "fraternal benefit society" is a type of social organization that provides insurance to its members.

SVO (continued)

Asset Valuation Reserve

Most life insurance companies and fraternal benefit societies[5] are required to establish and maintain an Asset Valuation Reserve, (AVR) so that certain asset-related risks are reflected in the insurers' balance sheets. The AVR has two main components, the default component and the equity component. Each component in turn is comprised of two subcomponents, which are described below. The annual contribution to the reserve is based on the maximum for each subcomponent less the existing balance times a phase-in percentage. The phase-in percentage was established to mitigate the financial impact of the establishment of the AVR, which became effective with the 1992 Annual Statement. Beginning with the 1995 Annual Statement, the phase-in credit is no longer used.

1. The **Default Component** addresses future credit-related losses on fixed income investments such as bonds, preferred stock, and mortgages. The Default Component is comprised of two subcomponents:

    a. Bond and Preferred Stock Subcomponent. The maximum reserves for the various NAIC designations for bonds and preferred stock are as follows:

NAIC #	Bonds	Pr. Stock
1	1 percent	3 percent
2	2	4
3	5	7
4	10	12
5	20	22
6	20	22

    b. Mortgage Subcomponent. Maximum reserves for mortgages initially are set at 3.5 percent of statement value times an Experience Adjustment Factor (EAF). The EAF causes the mortgage reserve to reflect an individual company's experience with mortgages. It will cause this reserve to range between 1.75 percent and 10.5 percent, depending on adjustments for individual company experience in delinquencies and foreclosures relative to the industry average[6].

[5] A "fraternal benefit society" is a type of social organization that provides insurance to its members.

[6] EAF equals the sum of the company's current period foreclosure and ninety-day delinquencies divided by a two-year average of a similar figure for the entire insurance industry.

2. The **Equity Component** covers all types of equity investments and is composed of two subcomponents:

    a. Common Stock Subcomponent. The maximum reserve is as follows:
    *Unaffiliated publicly traded common stocks---20 percent times a weighted average portfolio beta factor[7];

    *Unaffiliated private common stocks---25 percent;

    *Common stock of an affiliated life company, if that company also is required to maintain an AVR--- no reserve;

    *Affiliated companies valued under Sections 4(B)(i) or 4(B)(iii) of the SVO procedures---20 percent.

    b. Equity Real Estate Subcomponent. The maximum reserve for real estate is 7.5 percent of statement value times the sum of the book value and any encumbrances of the property.

3. Other Invested Assets. Other assets are to be categorized in any one of the above categories (i.e., bond or equity) and reserved for accordingly. Assets not so classified have a maximum reserve of 20 percent.

The SVO provides designations only for bonds and preferred stocks. It also provides year-end market prices for bonds, preferred stocks, and common stocks. The SVO does not make valuation judgments on mortgages or equity real estate. Securitized mortgage or asset-backed securities are required to be carried on an insurer's bond holding schedules and are required to be rated by a nationally recognized statistical rating organization (NRSRO) to be rated by the SVO.

Interest Maintenance Reserve

The Interest Maintenance Reserve (IMR) is a new reserve created to capture certain gains and losses formerly captured by the Mandatory Securities Valuation Reserve (MSVR)[8]. Specifically realized gains and losses from bond and mortgage transactions that are not related to a change in the credit quality of the security are captured in the IMR. The reserve captures

[7] See SVO Purposes and Procedures Section 5(B)(g)(iii)(1) for the formula to compute the beta factor.

[8] The MSVR is the asset reserving system that was the AVR's predecessor. It required insurers to establish reserves for securities they owned and is now known as the Bond and Preferred Stock Subcomponent and the Common Stock Subcomponent of the AVR.

the realized capital gains and losses that result from changes in the overall level of interest rates and amortizes these gains or losses into income over the remaining life of the investment. Unlike the AVR, it is not subject to any maximum or minimum.

Examples of transactions that would be included in the IMR include bond and mortgages transactions to adjust a portfolio's yield, quality or duration. This reserve is not a valuation reserve, and it appears in the policyholder liability section of the balance sheet. The IMR is designed to assist a valuation actuary in certifying that assets are properly duration-matched with liabilities and that the assets are good and sufficient to discharge those liabilities under a wide variety of economic scenarios.

Gains and losses from all fixed income investments are included in the IMR including U.S. Government "full faith and credit" securities. These gains and losses are then amortized out of the reserve and into income over the remaining life of the asset. The amortization may be done on a bond-by-bond or grouped method.